

Message Text

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PAGE 01 LONDON 04744 01 OF 03 231908Z
ACTION EUR-12

INFO OCT-01 EA-10 IO-13 ISO-00 SP-02 USIA-06 AID-05
EB-08 NSC-05 SS-15 STR-07 OMB-01 CEA-01 CIAE-00
COME-00 FRB-03 INR-10 NSAE-00 XMB-02 OPIC-03
LAB-04 SIL-01 L-03 H-01 PA-01 DOE-15 SOE-02 /131 W
-----107521 231931Z /43

R 231755Z MAR 78
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 4524
TREASURY DEPT WASHDC
INFO AMEMBASSY BONN
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO
AMEMBASSY BRUSSELS
USMISSION GENEVA

LIMITED OFFICIAL USE SECTION 01 OF 03 LONDON 04744

USEEC ALSO FOR EMBASSY
USOECN ALSO FOR EMBASSY
USMTN

DEPARTMENT PASS FEDERAL RESERVE BOARD

TREASURY FOR DONALD E. SYVRUD, OASIA

E.O. 11652: N/A
TAGS: EFIN, UK
SUBJECT: UK ECONOMIC FORECAST FOR 1978 - UPDATE

REF: LONDON 648

1. LONDON 648 REMAINS GENERALLY VALID AS OUR BEST JUDG-
MENT OF THE OUTLOOK FOR 1978. HOWEVER, WITH THE FIRST
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PAGE 02 LONDON 04744 01 OF 03 231908Z

QUARTER NEARLY COMPLETE, IT IS POSSIBLE TO REFINE SOME OF
OUR EARLIER COMMENTS.

2. GDP. THE 3 PERCENT AVERAGE ESTIMATE PROBABLY IS
SLIGHTLY OPTIMISTIC AS NET EXPORTS HAVE WEAKENED MORE
RAPIDLY THAN WE ANTICIPATED. IT MAY REQUIRE A SOMEWHAT
LARGER NET FISCAL STIMULUS IN APRIL TO ACHIEVE A 3 PERCENT

FIGURE. THE 2.7 PERCENT FIGURE AT THE LOWER END OF THE RANGE IS MORE LIKELY.

3. CONSUMPTION. INCREASINGLY IMPORTANT IS THE BEHAVIOR OF THE SAVINGS RATIO. SOURCES AT HM TREASURY DO NOT BELIEVE THAT THE SAVINGS RATIO WILL FALL PRECIPITATELY FROM ITS CURRENT ELEVATED LEVEL. THE TREASURY MODEL NOW INCORPORATES A SIGNIFICANT REAL BALANCE EFFECT, SPREAD OVER MORE THAN FOUR QUARTERS. AS A RESULT, THEY BELIEVE THAT THE INCREASE IN CONSUMPTION IN 1978 WILL BE PROPORTIONATE TO INCOME.

4. EARNINGS. EVIDENCE IS ACCUMULATING THAT THE INCREASE IN AVERAGE EARNINGS FOR THE CURRENT PAY ROUND WILL BE IN THE 12 TO 14 PERCENT RANGE. IN COMING WEEKS, MORE ATTENTION WILL CENTER ON DEVISING A NEW POLICY FOR THE PAY ROUND BEGINNING IN AUGUST 1978. WHILE IT WOULD BE CONVENIENT TO SAY THAT LABOR MARKET FORCES WILL DETERMINE THE RISE IN WAGES, IT IS CLEAR THAT HMG WILL SPARE NO EFFORT IN DEVELOPING A STAGE IV INCOMES POLICY. WHATEVER POLICY FOR WAGE RESTRAINT EMERGES, IT WILL INFLUENCE THE SUBSEQUENT CLIMATE FOR BARGAINING. THE GOVERNMENT WILL PRESS FOR AN EARNINGS INCREASE WELL BELOW THE CURRENT 10 PERCENT TARGET. THE TASK MAY BE SOMEWHAT EASIER THAN IT WAS IN 1977 SINCE RETAIL PRICE INCREASES WILL STILL BE IN SINGLE DIGITS WHEN THE PAY ROUND BEGINS, INCOME TAX LIMITED OFFICIAL USE

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PAGE 03 LONDON 04744 01 OF 03 231908Z

CUTS WILL BE BOOSTING TAKE-HOME PAY, AN ELECTION MAY WELL BE IMMINENT, AND, WITH CURRENT INDICATIONS OF LABOR HOARDING, THE DEMAND FOR LABOR LESS THAN BUOYANT.

5. RETAIL PRICES. THE RETAIL PRICE INCREASE FOR 1978 SHOULD FALL IN THE 8 - 9 PERCENT RANGE WITH 10 PERCENT THE UPPER LIMIT. THIS ASSUMES THAT THE CHANCELLOR WILL DO LITTLE TO INCREASE INDIRECT TAXES IN THE BUDGET, THAT CURRENT HIGH INVENTORY LEVELS WILL CUSHION THE PRICE IMPACT OF RISING CONSUMER DEMAND, AND THAT THE EFFECT OF STERLING'S 1977 IMPROVEMENT HAS NOT BEEN FULLY FELT ALONG THE CHAIN OF PRODUCTION AND DISTRIBUTION.

6. INDUSTRIAL PRODUCTION. THE UPTURN IN MANUFACTURING PRODUCTION WILL BE DELAYED BY THE DESIRE TO RUNDOWN EXCESS INVENTORIES. HOWEVER, BY END-YEAR, OUTPUT SHOULD BE RISING MORE STRONGLY. CONSTRUCTION WILL BE BOLSTERED BY A SUBSTANTIAL INJECTION OF GOVERNMENT EXPENDITURE AND A RECOVERY IN PRIVATE HOUSING IS ALREADY UNDERWAY.

7. PRODUCTIVITY AND EMPLOYMENT. MOST SIGNS POINT TO

SUBSTANTIAL CURRENT LABOR HOARDING. THIS SHOULD PERMIT
AN INCREASE IN THE LEVEL OF OUTPUT WITHOUT GENERATING MUCH

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PAGE 01 LONDON 04744 02 OF 03 231908Z
ACTION EUR-12

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LAB-04 SIL-01 L-03 H-01 PA-01 DOE-15 SOE-02 /131 W
-----107530 231930Z /43

R 231755Z MAR 78
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 4525
TREASURY DEPT WASHDC
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AMEMBASSY PARIS
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LIMITED OFFICIAL USE SECTION 02 OF 03 LONDON 04744

ADDITIONAL PRESSURE ON LABOR MARKETS.

8. INVESTMENT. RECENT SURVEY EVIDENCE CONTINUES TO SUP-
PORT A RECOVERY IN PRIVATE SECTOR INVESTMENT WITH A 10-15
PERCENT VOLUME INCREASE STILL LIKELY. OVERALL FIXED CAPI-
TAL EXPENDITURE IN MANUFACTURING WILL BE AFFECTED BY RE-
DUCED OUTLAYS BY THE STATE-OWNED BRITISH STEEL CORPORATION.

9. GOVERNMENT. OUR BEST GUESS IS THAT GOVERNMENT EX-
PENDITURE FOR GOODS AND SERVICES ON A NATIONAL INCOME
ACCOUNTS BASIS WILL RISE BY JUST OVER 3 PERCENT IN THE
FISCAL YEAR BEGINNING APRIL 1, 1978. THIS IS CONSISTENT
WITH A RISE OF ABOUT 2 - 2.5 PERCENT FOR CALENDAR 1978.
WE CONTINUE TO EXPECT A NET STIMULUS OF ABOUT 2.0 BILLION
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PAGE 02 LONDON 04744 02 OF 03 231908Z

POUNDS IN THE BUDGET LARGELY WEIGHTED TOWARD CUTS IN INCOME TAXATION. TOKEN EXPENDITURE INCREASES IN CONSTRUCTION, AND THE HEALTH SERVICES, AND SCHOOL MEAL SUBSIDIES ARE ALSO LIKELY.

10. PUBLIC SECTOR BORROWING -- MONEY SUPPLY. THE PSBR FOR FY 77/78 SHOULD FALL IN THE 5.5 - 6.0 BILLION POUND RANGE, CONSIDERABLY BELOW THE LAST FORECAST OF 7.5 BILLION POUNDS. A ROLLING TARGET FOR STERLING M3 IS LIKELY TO BE INTRODUCED FOR THE BANKING YEAR BEGINNING IN APRIL WITH SEMI-ANNUAL RATHER THAN QUARTERLY ADJUSTMENTS THE MOST PROBABLE FORMAT. WE BELIEVE THE CHANCELLOR MAY SET THE INITIAL TARGET RANGE FOR M3 SLIGHTLY BELOW ITS CURRENT UPPER LIMIT OF 13 PERCENT. THAT SAID, IT IS INCREASINGLY LIKELY THAT THE CURRENT TARGET WILL BE EXCEEDED. DESPITE SOME RECENT SUCCESS IN THE SALE OF GOVERNMENT DEBT OUTSIDE THE BANKING SYSTEM, THE GROWTH IN STERLING M3 IN THE YEAR TO MID-APRIL 1978 SHOULD BE A PERCENTAGE POINT OR SO ABOVE THE 13 PERCENT FIGURE.

11. BALANCE OF PAYMENTS (POUNDS MILLIONS)

	1977	1978
PETROLEUM EXPORTS (FOB)	1,965	2,800
PETROLEUM IMPORTS (FOB)	-4,769	-4,400
PETRO BALANCE	-2,804	-1,600
NON-OIL EXPORTS (FOB)	30,211	32,400
NON-OIL IMPORTS (FOB)	-29,019	-32,100
NON-OIL VISIBLES BALANCE	1,192	300
VISIBLE BALANCE	-1,612	-1,300
INVISIBLES BALANCE	1,577	1,800
CURRENT ACCOUNT	- 35	500

THESE ESTIMATES ARE CONSISTENT WITH THE ROUGH ORDER OF MAGNITUDE:

1. NON-OIL EXPORT FOREIGN CURRENCY PRICES GROWING

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PAGE 03 LONDON 04744 02 OF 03 231908Z

- 8 PERCENT AND NON-OIL IMPORT FOREIGN CURRENCY PRICES GROWING AT 7 PERCENT;
 2. NON-OIL EXPORT VOLUME GROWING AT 4.0 PERCENT AND IMPORT VOLUME AT 7.0 PERCENT;
 3. A TRADE-WEIGHTED STERLING INDEX OF 64 - 65.
- WE ARE DELIBERATELY ADOPTING A MORE CAUTIOUS STANCE ON CURRENT ACCOUNT. THE VISIBLE TRADE ESTIMATES ARE MADE WITH A PROBABLE ERROR OF 100-200 MILLION POUNDS. THE INVISIBLES BALANCE HAS A PROBABLE ERROR OF 200 MILLION POUNDS. WE ASSUME THAT THE CURRENT ACCOUNT HAS

APROBABLE ERROR OF 200 MILLION POUNDS AND IS MOST LIKELY
TO WIND UP IN A RANGE OF 400-800 MILLION POUNDS SURPLUS.

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PAGE 01 LONDON 04744 03 OF 03 231910Z
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LAB-04 SIL-01 L-03 H-01 PA-01 DOE-15 SOE-02 /131 W
-----107563 231929Z /43

R 231807Z MAR 78
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 4526
TREASURY DEPT WASHDC
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LIMITED OFFICIAL USE SECTION 03 OF 03 LONDON 04744

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12. THE FOLLOWING TABLE UPDATES PARAGRAPH 11 OF LONDON
648:

	PERCENT CHANGE FROM PREVIOUS YEAR		
	1977	1978	
GDP	0.8	2.5 - 3.0	
CONSUMPTION		-0.8	3.5 - 4.0
FIXED INVESTMENT		-4.3	4.0 - 6.0
MANUFACTURING INVESTMENT		7.9	10.0 - 15.0
INVENTORY CHANGE (1)	0.9	0.0 - 0.5	
GOVERNMENT EXPENDITURE		-0.2	1.5 - 2.0

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PAGE 02 LONDON 04744 03 OF 03 231910Z

VISIBLE TRADE BALANCE (2)	-1-6	-1.1 - -1.5
INVISIBLE TRADE BALANCE (2)	1.6	1.6 - 2.0
CURRENT ACCOUNT (2)	0.0	0.4 - 0.8
INDUSTRIAL PRODUCTION	1.4	3.0 - 4.0
UNEMPLOYMENT RATE (3)	6.0	5.8 - 6.0
RETAIL PRICES	15.9	8.0 - 10.0

(1) - AS A PERCENT OF GDP

(2) - BILLIONS OF POUNDS

(3) - FOR DECEMBER

STREATOR

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